

REPORT OF ACCOMPLISHMENTS

1995 – 1998

“PROTECTING CALIFORNIA’S CONSUMERS”

CONSUMER PROTECTION

One of the fundamental goals of state insurance regulators is to closely monitor the financial integrity of the insurance industry and protect consumers and others against insurer insolvency. Despite regulators’ best efforts, however, financially troubled insurance companies can become bankrupt.

In the past, CDI’s ability to protect the interests of consumers against insurer insolvency was severely handicapped. Mismanagement and ineffective operations in CDI’s Conservation and Liquidation Office plagued CDI for many years. One of the most notable achievements for CDI has been to restore its ability to undertake sound regulatory actions with respect to troubled companies by addressing and correcting these problems.

CDI’s efforts have directly resulted in providing greater returns to policyholders from liquidated assets of insolvent insurers and preserving jobs at troubled insurance companies. CDI’s experiences in California have also enabled the Department to provide national leadership in the area of conservation and liquidation.

Restoring the Conservation and Liquidation Office

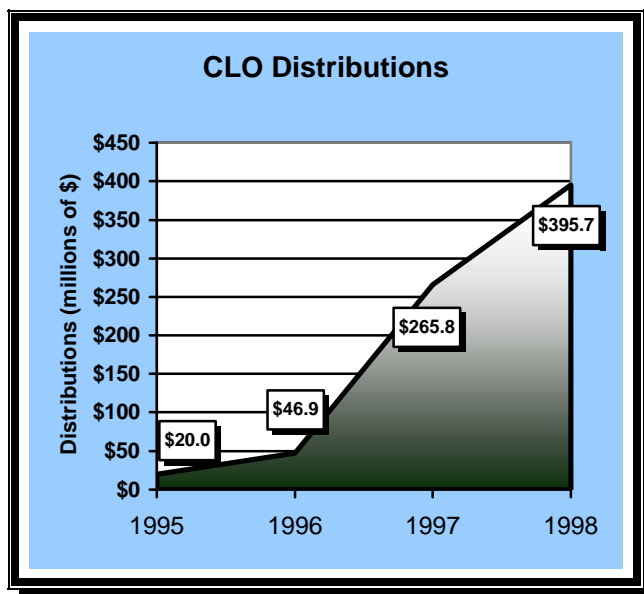
By the end of 1994, CDI’s Conservation and Liquidation Office (CLO) had been the subject of three management audits, numerous legislative hearings and extensive investigative reports by the media across California. CLO had developed a reputation for failing to safeguard the assets of those who were insured by bankrupt insurance companies under state supervision. *The Sacramento Bee* ran a three-part series on the serious mismanagement of assets by the CLO, including “private auctions” of conserved company assets to state employees at discount prices.¹

From 1995 through 1998, CDI has worked to transform the CLO into a model of how to manage the affairs of conservations and receiverships in California for the benefit of its claimants. Today, the CLO is maximizing its available resources to protect consumers who were shortchanged by

their bankrupt insurance companies and has become one of the premier receivership operations in the country.

From 1995 to 1997, the CLO closed 34 insolvent estates in just two years compared to 29 cases closed during the previous four years. Between 1995 and 1998, CLO assisted policyholders in recovering nearly \$730 million from insurance companies, returning \$395.7 million in 1998 alone.² *Exhibit 26* summarizes the amount of distributions returned to consumers.

Exhibit 26: Conservation and Liquidation Office Distributions



Source: California Department of Insurance, Conservation and Liquidation Office, 1999.

Early Warning System

The *Early Warning System* is an instrumental tool in CDI’s policyholder protection effort. CDI’s internal resources have been strengthened for analyzing the fiscal health of

¹ *Sacramento Bee*, February 20-22, 1994.

² California Department of Insurance, Conservation and Liquidation Office, 1999.

insurers, providing valuable lead-time for CDI to intervene and protect the interests of consumers before viability concerns become critical.

CDI has also enhanced its financial surveillance through increased staffing of the *Troubled Companies Unit* and providing staff training to develop more comprehensive automated analytical tools to diagnose the financial condition of insurers.

These strengthened monitoring efforts are working; the number of insolvencies has decreased from 112 in 1995 to 69 today.

A Case Study

Through more effective operations within the CLO, CDI has protected the interests of policyholders. For instance, on January 31, 1997 CDI seized one of the state's largest writers of workers' compensation insurance, to protect its policyholders from unsafe management practices.³ The insurance company had attempted to conceal the true financial condition of the company from CDI's financial examiners. In September 1996, a CDI investigation discovered that the company was under-reserved by \$138.5 million and was in imminent danger of collapsing. The company's demise would have left thousands of consumers unprotected.

Within four months, CLO seized the company, stabilized it, sold it and put it back into the private sector under new management.⁴ Not only did policyholders benefit from this action, but it also saved over 1,200 jobs in San Diego. The company has now been rehabilitated and is again operating as a viable going concern.

National Leadership on Insurer Insolvency Issues

The experiences in California have made CDI a national leader in solvency screening. California, along with a handful of other states – New York, Ohio, Pennsylvania, and Texas – have developed sophisticated approaches to protect consumers against insurer insolvency.⁵ CDI also actively participates on committees and task forces of the NAIC to enhance insurance regulators' ability to promote and protect the solvency of insurance companies.⁶

- **Accounting Practices and Procedures Task Force** – Identifies, investigates, and

develops solutions to accounting problems with the goal of guiding insurers in properly accounting for various aspects of their operations. Modifies the *Accounting Practices and Procedures* manuals to reflect changes necessitated by task force action and studies innovative insurer accounting practices that affect the ability of regulators to determine the true financial condition of insurers. This task force has overseen a complete re-codification of statutory accounting principles (SAP) and the establishment of a comprehensive process to maintain SAP.

- **Risk Based Capital Task Force** – Evaluates and recommends appropriate refinements to capital requirements for all types of insurers.
- **Special Insurance Issues Committee** – Addresses special issues relating to miscellaneous lines of insurance such as title, surety, fidelity, mortgage, and reinsurance.
- **Valuation of Securities Task Force** – A forum for proposed changes or interpretations of the *Purposes and Procedures of the Securities Valuation Office*. This document governs how the SVO staff values securities and constitutes the task force's permanent instructions to the staff on valuation matters. Reviews new investment vehicles being purchased by insurers and provides appropriate annual statement disclosure, credit evaluation techniques, and valuation methods.
- **Special Committee on Financial Services Modernization** – Addresses issues related to regulating the insurance activities of banks and other entities that offer a mixture of financial/insurance products in the US.
- **Casualty Actuarial Task Force** – Identifies, investigates and develops solutions to actuarial problems in the property and casualty insurance industry to maintain the financial health of property and casualty insurers.
- **Life and Health Actuarial Task Force** – Identifies, investigates, and develops solutions to actuarial problems in the life and health insurance industry to maintain the financial solvency of life and health insurers.

Innovative De-mutualization Efforts

Nationally, about 100 of the nation's 1,200 life insurance companies are organized and operate as what is referred to as *mutuals*, but this handful of companies issue approximately one-third of the 195 million individual life insurance policies in force and the same proportion of the in-

³ California Department of Insurance, Press Release #050, June 2, 1997.

⁴ *Insurance Commissioner of the State of California vs. Golden Eagle Insurance Company*, Case No. 984502, Superior Court of the State of California for the County of San Francisco, February 4, 1998.

⁵ Klein, Robert W., "Structural Change and Regulatory Response in the Insurance Industry," June 19, 1995.

⁶ National Association of Insurance Commissioners, 1999 Committee List: Committee, Subcommittee, and Task Force Assignments, January 27, 1999.

dustry's \$346 billion in assets.⁷ Legislation to allow de-mutualization has been enacted in California, as well as 15 other states and Washington, DC. During the period of 1995 to 1998, CDI oversaw the de-mutualization of an insurance company which was then the largest mutual life insurer in California.

“De-mutualization” refers to a mutual life insurer (i.e. an insurer that is mutually owned by its policyholders) that is converting to a stock company. To convert, each individual policyholder's interest must be accurately calculated and a distribution of that value must be effected. This distribution could take the form of stock transfers, cash, or credits to policyholders. De-mutualization gives life insurers greater organizational flexibility and ready access to capital in an era of consolidation and increasing competition from banks, mutual funds, and other sectors of the financial services industry. Consumers can potentially reap tremendous benefits from de-mutualization by receiving equity in the newly reorganized insurer and by the superior financial footing of the insurer.



⁷ New York State Assembly, Standing Committee on Insurance, Alexander B. Grannis, Chair, March 1998.